

General Information Letter: Illinois tax treatment of Subchapter S corporation and shareholders in Section 338(h)(10) election.

June 23, 1998

Dear:

This is in response to your letter dated June 15, 1998, in which you request a letter ruling. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter you have stated the following:

We have a client who is a New Jersey S-Corporation who files an Illinois IL-1120-ST. This client is selling 100% of its stock to an unrelated corporation and is making an election under IRC 338(h)(10) via Federal Form 8023 to treat the stock sale as a sale of corporate assets.

Under IRC Sec. 338(h)(10), our client will file a short year Federal return on the date of sale recognizing the gain which will flow through to the individual shareholders. The corporate name and Federal EIN will transfer to the buyer who will also get a stepped up basis in the assets sold.

Does the State of Illinois recognize/follow this Federal election?
Are there any state rulings on this issue?

Ruling

The Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 et seq.) does not specifically state whether or not the election provided by Internal Revenue Code (IRC) section 338(h)(10) shall be recognized or followed for Illinois income tax purposes. Under the IITA, Subchapter S corporations ("S corporations") are exempt from the income tax imposed at section 201(a) (See § 205(c)). At the same time, though, an S corporation is subject to the Personal Property Tax Replacement Income Tax imposed at section 201(c), measured by the "net income" of the corporation. The net income of a corporation is defined as the corporation's "base income," which is an amount equal to its "taxable income," adjusted by certain specific modification provisions (See IITA § 203(b)(1),(2)). In the case of an S corporation, taxable income is defined as:

[T]he taxable income of such corporation determined in accordance with Section 1363(b) of the Internal Revenue Code, except that taxable income shall take into account those items which are required by Section 1363(b)(1) of the Internal Revenue Code to be separately stated (IITA § 203(e)(2)(G)).

An S corporation's net income subject to the Personal Property Tax Replacement Income Tax is then finally determined by application of the allocation and apportionment provisions of Article 3 of the IITA (See IITA § 308(c)).

The IITA does not contain any addition or subtraction modification provision relating to amounts included in or excluded from the taxable income of an S corporation as the result of a section 338(h)(10) election. Hence, insofar as the § 338(h)(10) election results in separately and non-separately stated taxable income under section 1363 of the Internal Revenue Code, and to the extent such income is allocated and/or apportioned to Illinois, your client will be subject to the Personal Property Tax Replacement Income Tax.

In the case of an individual, the Illinois income tax is imposed upon the amount of the individual's federal adjusted gross income, as modified by certain specific modification provisions, allocated or apportioned to Illinois (See IITA §§ 202, 203(a), 301-304, 308). The IITA contains no addition or subtraction modification relating to items included in or excluded from federal adjusted gross income of an S corporation shareholder as the result of a section 338(h)(10) election. Hence, with regard to individual shareholders, any item included in federal adjusted gross income as the result of a section 338(h)(10) election will be included in base income and will be subject to Illinois income tax to the extent allocated and/or apportioned to Illinois. Similarly, any amounts excluded from federal adjusted gross income as the result of a § 338(h)(10) election will not be subject to income tax in Illinois.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Brian L. Stocker
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